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No. 88-40

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In the Supreme Court of the United States

OCTOBER TERM, 1988

UNITED STATES OF AMERICA, PETITIONER

v.

FRANK S. ZOLIN, ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

REPLY BRIEF FOR THE UNITED STATES

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1. a. Respondents suggest (Br. in Opp. 8-10) that the questions presented in this case are moot. These questions concern the enforceability of a summons issued by the IRS pursuant to an investigation into the tax liability of L. Ron Hubbard and others for tax years 1979-1983. While this case was pending in the Ninth Circuit, it was suggested to the court of appeals that another appeal concerning a different summons issued pursuant to the same investigation, *United States* v. *Author Services, Inc.*, 804 F.2d 1520 (1986), had been mooted by Hubbard's death on January 24, 1986. The Ninth Circuit rejected that suggestion and held that neither the appeal in *Author Services* nor the appeal in this case was moot, explaining that the civil elements of the investigation were not affected by Hubbard's death because the results of the investigation could affect

the tax liability of Hubbard's estate. *Id.* at 1522 n.1; Pet. App. 13a.[1] Respondents now suggest that this case has subsequently become moot, asserting that the civil audit of Hubbard's returns for the years in question has been terminated by the execution of IRS Forms 870 and therefore that there are no remaining IRS proceedings, either criminal or civil, that would justify enforcement of the summons.

This contention is without merit. It is based on an erroneous premise because the administrative actions taken by the IRS regarding Hubbard's civil tax liability have not ended the investigation. Rather, the controversy in this case remains live since the IRS has a continuing need for the summoned information in order to complete its investigation of Hubbard's tax liability (primarily with respect to whether fraud was committed) and of the possible criminal activity of other individuals connected with Hubbard (see note 1, *supra*).

Respondents contend that the IRS has resolved Hubbard's tax liabilities for the years in question, and therefore the information sought by the summons can serve no useful purpose. Clearly, however, this conclusion can be

[1] In addition to the continuing civil investigation, the government pointed out to the court of appeals that the criminal investigation was not ended by Hubbard's death because he was not the only target of the investigation; rather, the summons had been issued in furtherance of "a federal tax investigation involving various individuals connected with the Church of Scientology, including Lafayette Ronald Hubbard ('L. Ron Hubbard'), relating to possible criminal and civil violations of the Internal Revenue Code and related provisions" (Declaration of Special Agent Petersell in Support of Petition to Enforce Summons, para. 2, C.A. App. 21). See U.S. C.A. Reply Br. 22 n.12. Finding the existence of a continuing civil investigation of Hubbard to be sufficient to reject the mootness claim, the court of appeals did not discuss whether the existence of other unnamed targets of the investigation would also defeat the mootness claim.

correct only if the IRS has made a "final, irrevocable determination" (*United States* v. *Gimbel*, 782 F.2d 89, 93 (7th Cir. 1986)) as to Hubbard's tax liability; if the IRS remains free to make further determinations concerning that liability in response to new information obtained from enforcement of the summons, it is manifest that the enforcement action is not moot. But respondents' premise that Hubbard's tax liability has been irrevocably resolved is erroneous; it rests on an apparent misunderstanding of the IRS's procedures and terminology.

b. Respondents do not contend that Hubbard's tax liability for the years in question has been resolved by operation of law; indeed, the statute of limitations for tax years 1981-1983 was extended by agreement and does not expire until June 30, 1989. Rather, respondents contend that it is the operation of the IRS's own internal procedures that has mooted this case; respondents claim that the IRS has irrevocably terminated consideration of Hubbard's tax liability by its own actions in ending its audit and accepting executed Forms 870 for the years in question.[2] As described in Treas. Reg. § 601.105(b)(4), the execution of a Form 870 by a taxpayer reflects his agreement with the changes proposed by the examiner as a result of an audit. The regulation notes that "[a]s a matter of practice * * *, [such] waivers or acceptances ordinarily result in the closing of a case insofar as the Government is concerned." But an agreement with the findings of the audit examiner, even if it ordinarily results in the administrative "closing" of the case, does not irrevocably terminate the determination of the taxpayer's liability, and therefore it

[2] Although respondents state that Forms 870 were executed for the years 1979-1983 (Br. in Opp. 8-9), we are informed by the IRS that they were executed only for the years 1981-1983. No Form 870 was submitted by Hubbard's representative for the tax years 1979-1980 because no audit changes were made for those taxable years.

cannot operate to terminate the IRS's investigation and moot a summons enforcement action. All the Form 870 does is reflect an agreement as to the amount of tax liability, *subject to change in the event that new information is uncovered.*

First, the regulation upon which respondents rely plainly states that the execution of a Form 870 does not necessarily represent a final determination of tax liability. The "district director remains free to assess a deficiency" and the taxpayer "may still claim a refund" (Treas. Reg. § 601.105(b)(4)). Moreover, under IRS procedures, even the administrative "closing" of a case does not make further investigation of that case pointless. Rev. Proc. 85-13, 1985-1 C.B. 514, which implements the regulation upon which respondents rely, describes in detail the circumstances under which the IRS will reopen a closed case to make an adjustment unfavorable to the taxpayer. These include the discovery of "evidence of fraud," a substantial error, or other circumstances indicating that a failure to reopen would be a serious administrative omission. See *id.* at 515.[3]

A reopening due to the discovery of evidence of fraud is particularly relevant to the instant case because it is the possibility that the summoned documents in this case will yield evidence of fraud that is the primary reason why enforcement of the summons remains a live issue of considerable importance to the government. It was the suspi-

[3] The "closing" referred to in Treas. Reg. § 601.105 and Rev. Proc. 85-13 is to be distinguished from a "closing agreement" that is "final and conclusive" under Section 7121 of the Code. A "closing agreement" must be signed by all parties, and it can be signed on behalf of the IRS only by certain specified officers to whom this authority has been delegated. An examiner is not one of these delegated officers. See Rev. Proc. 68-16, 1968-1 C.B. 770. No "closing agreement" has been entered in connection with Hubbard's tax liabilities.

cion of fraud on the part of various individuals and entities connected with the Church of Scientology that, in large part, prompted the issuance of the summons at issue here. That original purpose for issuing the summons remains in force today because a final determination by the IRS regarding the existence of the suspected fraud should await a thorough examination of the documents sought to be obtained pursuant to the summons. If those documents demonstrate that Hubbard committed fraud in connection with his taxes for these years (and there is strong reason to believe that the documents do contain such evidence (see Pet. App. 23a-24a)), then other adjustments to Hubbard's tax liability for the years in question will be appropriate.

c. In any event, it is well established, even in contexts where the nonfraud aspects of a taxpayer's liability are more finally settled than they are by the execution of Form 870 or by the acceptance of the returns as filed, that controversies over summons enforcement remain alive because of the possibility that the investigation will reveal fraud. Section 6501(c)(1) of the Code permits an assessment to be made "at any time" in the case of a false or fraudulent return with the intent to evade tax. Thus, even if the statute of limitations on assessment had expired for the years in question, the IRS could still assert against Hubbard's estate additional income taxes and penalties grounded in civil fraud. See *Badaracco* v. *Commissioner*, 464 U.S. 386 (1984); see also *United States* v. *Powell*, 379 U.S. 48 (1964) (permitting enforcement of summons even though statute of limitations had expired).[4] In short, the

[4] Similarly, the issuance of a notice of deficiency and the consequent filing by the taxpayer of a Tax Court petition do not affect the IRS's summons authority, even though Section 6212(c) of the Code restricts the Commissioner's power to issue a second notice of deficiency. See *United States* v. *Gimbel*, 782 F.2d at 92-93; *United States* v. *Roundtree*, 420 F.2d 845, 847-848 n.3 (5th Cir. 1969); *National*

focus of respondents' suggestion of mootness—*i.e.*, the extent to which the nonfraud aspects of the IRS's examination have been completed—cannot extinguish the existence of a tax fraud investigation, and therefore the completion of the nonfraud aspects of an investigation do not moot a pending summons enforcement action.[5] Thus, for several reasons, respondents' suggestion of mootness is erroneous.[6]

2. Respondents argue (Br. in Opp. 14-15) that there is no direct conflict between the decision below and the Fifth Circuit's decision in *United States* v. *Barrett*, 837 F.2d

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Plate & Window Glass Co. v. *United States*, 254 F.2d 92, 93 (2d Cir.), cert. denied, 358 U.S. 822 (1958).

[5] Indeed, respondents' contention leads to an absurd and pernicious result. If the tentative completion of the nonfraud aspects of the investigation would bar further summons enforcement action, then this case would provide a blueprint for taxpayers to thwart legitimate tax fraud investigations. A taxpayer would have an incentive to take actions that serve no purpose other than to delay enforcement of a summons issued in furtherance of a fraud investigation if, as respondents maintain, his success in delaying enforcement long enough to allow completion of the nonfraud aspects of the investigation would require that enforcement efforts be halted.

[6] We note that, if respondents' suggestion of mootness were correct, the proper course of action for this Court would not be to deny certiorari, but rather would be to grant certiorari and to vacate the judgment below. See, *e.g.*, *United States* v. *Munsingwear*, 340 U.S. 36 (1950). While that action would eliminate the precedential value of the decision below, it would leave in place a direct conflict between *United States* v. *Barrett*, 837 F.2d 1341 (5th Cir. 1988), petition for cert. pending, No. 87-1705, and *United States* v. *Author Services, Inc.*, *supra*, on the validity of conditional enforcement of IRS summonses. It would also leave an apparent conflict between the Ninth Circuit's independent evidence rule described in *United States* v. *Shewfelt*, 455 F.2d 836, cert. denied, 406 U.S. 944 (1972), and the decisions of several other courts of appeals. See Pet. 19-20.

1341 (1988), petition for cert. pending, No. 87-1705, because of the differences in the conditions placed by the respective district courts on the enforcement of the summonses. But these differences do not affect the fundamental conflict between the two circuits on the general question whether any condition can be imposed on the enforcement of the summons. The Fifth Circuit in *Barrett* unequivocally held that "[t]he district court does not have the power to conditionally enforce the summons" (837 F.2d at 1350). Thus, there can be no doubt that the Fifth Circuit would have decided the instant case differently and would not have permitted the imposition of the restriction on disclosure of summoned material that was approved by the Ninth Circuit.

Similarly, the Ninth Circuit has expressly rejected the proposition that "the court is limited to either enforcing a summons or denying enforcement" (*United States* v. *Author Services, Inc.*, 804 F.2d at 1525), which is precisely the proposition upheld by the Fifth Circuit in *Barrett* (see 837 F.2d at 1350). Moreover, the Ninth Circuit stated that the decision in *United States* v. *Texas Heart Inst.*, 755 F.2d 469 (5th Cir. 1985), which was overruled in *Barrett*, was "sound," and the Ninth Circuit added that it agreed with *Texas Heart* that "a district court 'may require the IRS to abide by the disclosure provisions of the Internal Revenue Code before it enforces the summonses' " (804 F.2d at 1525 (quoting 755 F.2d at 481)). Thus, the Ninth Circuit is already on record as stating that it would approve the imposition of the same condition on enforcement that was ultimately rejected by the Fifth Circuit in *Barrett*. In sum, the conflict between the Ninth Circuit and the Fifth Circuit on the question presented here is irreconcilable. See generally Pet. 10-13.

3. Respondents assert (Br. in Opp. 17-19) that the validity of the Ninth Circuit's "independent evidence" requirement for the invocation of the crime-fraud exception

to the attorney-client privilege is not "squarely presented" (*id.* at 17) in this case. This assertion is clearly mistaken. As respondents note (*ibid.*), the district court did make a partial in camera examination of the contents of the disputed tapes, but that was not the basis for the court of appeals' decision that is the subject of this petition. The en banc court of appeals unequivocally stated that the rule of the Ninth Circuit is that, in order to invoke the crime-fraud exception, "the government must make a prima facie showing, independent of the communications involved, that the attorney-client communications were in furtherance of an intended or present illegality" (Pet. App. 2a). Accordingly, the court of appeals did not examine the contents of the tapes at all; the judgment below rests on the holding that, as a matter of law, the contents of the tapes could be not be considered in determining whether the crime-fraud exception applies (together with the attendant factual conclusion that the independent evidence here does not make such a prima facie showing (see Pet. App. 23a-24a)). As we explained in our petition (at 19-20), that holding conflicts with decisions in several circuits, and it is appropriate for the Court to grant certiorari to resolve the conflict.

To be sure, in the event that the judgment below is reversed on the ground that the independent evidence rule should not be applied, there will remain for consideration on remand the factbound question of whether the crime-fraud exception should be invoked in this case. That question, however, is not "preliminary" (Br. in Opp. 19) to consideration of the validity of the independent evidence rule; rather, it cannot be reached unless the independent evidence rule is rejected. We note that we disagree with respondents' assertion that this factbound question will be resolved on remand against invocation of the crime-fraud exception. We have consistently maintained that both the

partial transcripts provided to the district court and the complete tape recordings, which the government specifically requested the court to consider (see Pet. 6 n.3), demonstrate the applicability of the crime-fraud exception. In any event, that is a matter to be decided by the court of appeals on remand, and the prospect of a fact-bound dispute on remand provides no reason for this Court to refrain from resolving the conflict in the circuits on the broad legal question presented in the petition.[7]

For the foregoing reasons, and those stated in our petition, the petition for a writ of certiorari should be granted.

Respectfully submitted.

CHARLES FRIED
Solicitor General

OCTOBER 1988

[7] Although it is not appropriate to engage in an extended discussion of the merits at this stage of the proceedings, we note that respondents have misstated our position in one important respect. We do not argue for "an absolute requirement of review of the communications themselves" (Br. in Opp. 23) whenever requested by the government; we do argue that the court is not prevented from reviewing the documents in camera to determine whether the crime-fraud exception is applicable.

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